

Internal Revenue Service

memorandum

CC:EE-TR-45-575-91

Br2:AGKelley

date:

to: Chief, Appeals Office

Attn: [REDACTED] Appeals Officer

from: Assistant Chief Counsel

(Employee Benefits and Exempt Organizations) CC:EE

subject:

EIN: [REDACTED]

This is in reply to your request for assistance concerning the employment tax status of certain payments made by the above taxpayer.

The issue concerns whether the taxpayer is liable for federal employment taxes with respect to various expense allowances that it paid to its employees. In this memorandum, we agree that the expense allowances (to the extent determined by the agent) appear to be wages for federal employment tax purposes. However, we raise the possibility that the case presents a fairly strong argument for administrative relief by the Service. Accordingly, you may wish to reach a compromise agreement based on that possibility, or you may want to submit a formal technical advice for a determination as to whether the amounts at issue are wages and, if so, whether the taxpayer is entitled to relief under section 7805(b) of the Internal Revenue Code.

According to the information submitted, the tax years involved are [REDACTED] and [REDACTED]. The taxpayer contracts with telephone company clients to provide manpower to perform installation, repair, and testing services in connection with telephone systems. The duration of the workers' jobs is generally from two weeks to two years. Workers are assigned to districts or work centers where they report at the beginning of the day to receive their work assignments. The workers normally work in the field rather than at a specific office. The workers are required to have a truck and appropriate tools to do the job when they are hired. Occasionally, the taxpayer provides the initial set of tools and deducts the cost from the employee's pay. Also, occasionally the taxpayer may provide a vehicle for an employee.

The taxpayer paid the workers several different allowances that are at issue; (1) a truck allowance; (2) mileage allowance; (3) living expense allowance; and (4) tool allowance. The truck allowance is based on what the taxpayer claims it would cost to lease a vehicle or pickup truck over a two-year period; the taxpayer has determined this cost to be \$[REDACTED] per week. The

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mileage allowance is \$ [REDACTED] per week based on an estimated [REDACTED] miles business use per week at [REDACTED] cents per mile. The living expense allowance is \$ [REDACTED] per week, and is sometimes considered part of the truck allowance. The tool allowance is \$ [REDACTED] per week for installers and repairmen and splicers and \$ [REDACTED] per week for various other workers. The allowances are paid at an hourly rate which is determined by dividing the total weekly allowance awarded to each worker by 40. The workers are paid the allowance for overtime work as well as for the regular 40 hours, although the overtime hours are not used to calculate the hourly allowance rate.

If the taxpayer provides the truck, the worker does not receive a truck allowance but receives the other allowances. The allowances may vary to some extent between individuals; for example, a worker located in a rural area may receive a greater mileage allowance because he or she may have to travel greater distances to do the work assigned. The taxpayer does not have a written policy governing the allowances. According to the taxpayer, the allowances were paid to induce the workers to work for them and to meet the benefits provided by the taxpayer's competition. The taxpayer claims the allowance policy is reviewed about once a year and adjusted if necessary for cost-of-living increases. There is no written record of such reviews. The weekly pay check stub is marked to show two amounts, one for the weekly regular pay and one for the allowance portion of the weekly pay. The taxpayer did not withhold or pay federal employment taxes on the allowances paid. The allowances were reported on an employee's Form W-2 in Box 10 as "Wages, tips, other compensation." However, the allowances were not included in the box for "social security wages." The allowances constituted a large percentage of the amounts paid by the taxpayer to the workers.

The employees are not required to account and do not account to the taxpayer for expenses incurred with respect to the allowances. The allowances are paid on the basis of hours worked and not the actual expense incurred. The taxpayer does not maintain records indicating whether the job location was away from the employees' homes. The taxpayer has not conducted a survey of employees to determine average expenses incurred including business mileage driven per day or week for the classes of workers at each work center.

The taxpayer has prepared a chart comparing its estimate of the total expenses incurred by an employee with the actual amount of the travel/living allowance paid to the employee (which includes all the allowances). In many cases the amount of the allowance is less than the estimate of the expenses to be

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incurred; in general, the amount of the allowance is roughly equal to the taxpayer's estimate. There are numerous problems with the estimate of expenses prepared by the taxpayer; the net effect of these problems is that the taxpayer's estimate is probably much higher than the actual expenses occurred by any employee.

The examiner's position is that the vehicle allowance and the mileage allowance should be combined into one allowance that is based on business miles driven and computed using the standard mileage rate established by the Service for each year. The examiner has determined the number of business miles that will be allowed for each center based on the average miles driven in the work center. The examiner has determined the average miles in the work center by interviewing employees, one of the taxpayer's supervisors, representatives of telephone company clients, and by consideration of the work areas covered by the work centers.

Sections 31.3121(a)-1(h), 31.3306(b)-1(h), and 31.3401(a)-1(b)(2) of the Employment Tax Regulations provide that amounts paid specifically -- either as advances or reimbursements -- for traveling or other bona fide ordinary and necessary expenses incurred or reasonably expected to be incurred in the business of the employer are not wages and are not subject to withholding. Traveling and other reimbursed expenses must be identified either by making a separate payment or by specifically indicating the separate amounts where both wages and expense allowances are combined in a single payment. For amounts that are received by an employee on or after July 1, 1990, with respect to expenses paid or incurred on or after July 1, 1990, see sections 31.3121(a)-2T, 31.3306(b)-2T, and 31.3401(a)-2T of the temporary regulations.

In Rev. Rul. 190, 1953-2 C.B. 303, the company paid its employees flat amount allowances to cover their daily transportation expenses to and from a federal project, where sufficient skilled labor was not available in the immediate vicinity, pursuant to an authorization contained in an agreement between representatives of the Government and certain labor unions. Rev. Rul. 190 held that the transportation allowances were not wages for federal employment tax purposes, based on the regulatory provisions set forth in the preceding paragraph. Under Rev. Rul. 190, transportation allowances were not wages if they met the following requirements: (1) the allowances were for travel by the employees between the regular place of employment (the metropolitan area) and a strictly temporary work site outside the metropolitan area; (2) the allowances were reasonable allowances for transportation expenses as distinguished from

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payments for travel time; and (3) the allowances were specifically indicated as separate from regular wages.

In Rev. Rul. 74-445, 1974-2 C.B. 325, a construction company paid its employees a flat per diem allowance regardless of whether any travel expenses were expected to be incurred by the employee. The ruling held that the travel allowance payments were not advances or reimbursements for expenses incurred or reasonably expected to be incurred in the business of the employer. Accordingly, the ruling concluded that the "travel allowance" payments were additional remuneration to the employees and, as such, were "wages" for purposes of the FICA, the FUTA, and federal income tax withholding.

In Rev. Rul. 76-453, 1976-2 C.B. 86, the Service sought to revoke Rev. Rul. 190. In Example (5) of Rev. Rul. 76-453, an employee works at various temporary locations. The employee, pursuant to a union agreement, received a flat \$7 daily amount as reimbursement for the transportation expenses incurred. The employee was not required to account to the employer for such expenses. The ruling held that these payments were wages for income tax withholding purposes.

As originally issued, Rev. Rul. 76-453 was to be effective with respect to transportation costs paid or incurred on or after January 1, 1977. However, in Announcement 77-147, 1977-42 I.R.B. 45, the effective date of Rev. Rul. 76-453 was suspended indefinitely.

In Rev. Rul. 90-23, 1990-1 C.B. 28, the Service held that a taxpayer with one or more regular places of business is allowed a business expense deduction for transportation expenses paid or incurred by the taxpayer in going between the taxpayer's residence and a temporary work location, regardless of the distance traveled. That ruling would appear inapplicable to the instant case because the workers either (1) do not have a regular place of business, or (2) the locations at which they perform their services would be their regular places of business.

In Central Illinois Public Service Co. v. United States, 435 U.S. 21 (1978), 1978-1 C.B. 310, the United States Supreme Court held that a \$1.40 noon lunch reimbursement paid employees on nonovernight travel in 1963 was not wages subject to income tax withholding.

Under the facts of Situation 2 of Rev. Rul. 84-127, 1984-2 C.B. 246, an employer reimbursed its employees for business use of personal automobiles at the rate of 22.5 cents per mile during 1983. Employees were required to submit travel vouchers showing

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the miles traveled for ordinary and necessary business purposes in order to obtain the allowance. Under Service rulings, if an employer granted an allowance in 1983 not exceeding 20.5 cents per mile to an employee for ordinary and necessary transportation expenses, the arrangement was considered to be an accounting to the employer for purposes of sections 162 and 274. The ruling held that the employer in Situation 2 should report the entire amount of the reimbursement on the Form W-2, Wage and Tax Statement. The ruling also held that such amounts are not wages for purposes of the FICA, the FUTA, and federal income tax withholding, citing section 31.3401(a)-1(b)(2) of the regulations and Central Illinois.

In General Elevator Corp. v. United States, 20 Cl.Ct. 345 (1990), the United States Claims Court held that the plaintiff (GEC) was not liable for federal employment taxes with respect to certain travel payments that GEC paid its employees. Employees of GEC who were responsible for the installation of elevators ("field employees") were paid per diem payments based on the location of the job site with respect to three center points. The amounts of the per diem payments were computed by use of concentric circles from the center points. These payments were made regardless of the distance from the employee's home to the worksite and regardless of the actual travel expenses incurred by the employee. The amount of per diem paid to the workers did not vary according to the employee's wage rate or other employment factors. GEC paid both travel time and per diem to its field employees; only employment taxes with respect to the per diem was at issue. The per diem payments made by GEC were arbitrarily fixed and did not result from a definitive cost study of travel costs to and from various zones. GEC did not require any field employees to account for any expenses actually incurred relating to travel to job sites or to provide receipts for overnight lodging. The per diem payments were not reported on the Forms W-2, Wage and Tax Statements, of the employees.

The Claims Court concluded that the per diem payments were paid as an "aspect" of compensation for services performed. The court held that GEC's testimony that it made some effort to determine the employee's actual travel costs were unpersuasive because GEC "never performed a sound analysis of such costs." The court concluded that the per diem payments were wages within the meaning of section 3401(a), but nevertheless held that GEC was not liable for employment taxes with respect to the payments because it had no notice of any duty to withhold on the payments. In reaching that conclusion, the court cited Central Illinois, noted the indefinite suspension of Rev. Rul. 76-453, and pointed to a letter from an agent of the Service to another taxpayer concerning this issue. The court stated that Rev. Rul. 74-445,

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which held certain per diem payments to be wages subject to withholding, did not provide sufficient notice because the per diem payments in that revenue ruling were received whether or not the workers incurred any bona fide travel expenses, whereas all GEC's employees who received per diem incurred otherwise uncompensated bona fide travel expenses.

In General Elevator Corp. v. United States, A.O.D. 1812 (February 22, 1991), it is stated that the Service will not follow the decision in General Elevator. The A.O.D. notes that whether an employer had notice of a duty to withhold is pertinent to the issue of whether payments are wages and is not a secondary legal requirement for employment tax liability imposed subsequent to a finding that the payments are "wages." The A.O.D. states that appeal was not recommended in this case because the Service agreed to grant administrative relief pursuant to section 7805(b) of the Code to similarly situated taxpayers.

The allowances paid by the taxpayer in the case you have presented are not reasonably related to the expense incurred by the employee, and therefore, it appears that the allowances (to the extent calculated by the examiner) do not meet the exception from wages for expense reimbursements provided in the regulations. The evidence presented strongly suggests that the allowances were compensatory, and it appears that such amounts would not be excepted from wages for federal employment tax purposes. However, the question arises whether the administrative relief described in A.O.D. 1812 would be applicable in this type of fact situation.

Section 7805(b) of the Code provides that the Secretary may prescribe the extent, if any, to which any ruling or regulation relating to the internal revenue laws, shall be applied without retroactive effect.

With reference to A.O.D. 1812, the question of whether any entity is entitled to retroactive relief will be determined based on the particular facts and circumstances present with respect to the payment of travel pay by the entity. The Service has not published any general guidelines as to the granting of retroactive relief on this issue, and our comments should be understood to be advisory only. The Associate Chief Counsel (Technical) decides whether section 7805(b) relief is appropriate with respect to any particular ruling or technical advice memorandum (TAM). Although we are unable to address the retroactive relief question definitively in this memorandum, we will discuss some of the issues that we believe would be relevant.

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As noted in A.O.D. 1812, the administrative relief under section 7805(b) was intended to be provided to taxpayers who make payments of a similar nature to the payments at issue in General Elevator. Similar payments would include the allowances paid in Rev. Rul. 190 and the flat \$7 daily amount received as reimbursement for transportation expenses in example 5 of Rev. Rul. 76-453. Because the effective date of Rev. Rul. 76-453 was suspended, taxpayers could justifiably infer that the treatment of the payment described in Example 5 therein would continue as in Rev. Rul. 190, which would support a holding that the payment was not wages. Thus, in our view, the focus of an inquiry as to entitlement to administrative relief in any case should focus on the similarity of the facts in the case to the General Elevator per diem payments, the allowances in Rev. Rul. 190, and the flat payments in example 5 of Rev. Rul. 76-453.

There are similarities between the four allowances paid by the taxpayer in the instant case and the payments described in the preceding paragraph. It appears that the allowances were paid at the same rate for all employees, or varied based on the expectation that additional expenses would be incurred. There appears to be no correlation between the wage rate of the employee and the amount of the allowances received. If it could be demonstrated that the allowances increased as the basic wages of employees increased and that there was no reason why higher paid employees could be expected to incur higher amounts of expenses than the lower paid employees, a strong argument could be made that administrative relief would be inappropriate. In General Elevator and Rev. Rul. 190, the per diem payments were flat amounts that did not vary with the wage rate of the employees. For example, if it could be shown that the allowances were in the nature of "travel time" payments, the holding of Rev. Rul. 190 would not apply because Rev. Rul. 190 specifically indicates that it does not apply to travel time.

The showing that the expenses incurred by the employees were usually less than the amount of the allowances, and, therefore, that the amounts of the allowances were not reasonably related to the expenses incurred is also not inconsistent with the holding in General Elevator. Thus, such a finding alone should not be sufficient to deny administrative relief under the standard set forth in A.O.D. 1812. The only requirement for removing the case from the scope of Rev. Rul. 74-445 (which held certain per diem payments to be wages for federal employment tax purposes), according to the court, is a finding that the employees receiving the allowances may be expected to incur some deductible business expenses. It has apparently been established in this case that the employees do incur some deductible business expenses.

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Many of the other facts in this case are similar to General Elevator and Rev. Rul. 190. The workers are not required to account for expenses to the taxpayer. The allowances were paid without regard to the location of the employees' homes. The allowances are significant in amount. There is no evidence (e.g., a survey) of an effort by the taxpayer to have the allowances closely approximate actual expenses expected to be incurred.

However, the facts in this case are distinguishable in several respects from the holdings in General Elevator, Rev. Rul. 190, and Rev. Rul. 76-453. In this case the employee is paid the allowances at an hourly rate, so that if he or she works overtime additional amounts of the allowance will be received, even though a portion of the allowances is said to be related to "fixed costs". In the rulings and General Elevator, the employees were paid a flat amount daily. Thus, because the allowances are paid on an hourly basis, the allowances assume more of the character of an hourly wage payment.

The amount of the allowances in this case is so great that it is perhaps unrealistic for anyone to believe that the allowances were intended in their entirety to be reimbursements for travel and business expenses incurred. The taxpayer's estimate of expenses expected to be incurred has obvious flaws that clearly resulted in a gross overstatement of business expenses expected to be incurred by an employee. However, it should also be noted that there was evidence in General Elevator that the per diem payment in certain cases constituted a large part of the employees' compensation, and that the court in fact held that the payments were compensatory in reaching a holding that GEC could not be held liable for employment taxes with respect to the per diem payments.

In summary, the allowances paid by the taxpayer in this case have many similarities with the payments in General Elevator, Rev. Rul. 190, and Example 5 of Rev. Rul. 76-453, and thus, appear to offer a fairly strong case for administrative relief. However, there are some distinguishing characteristics that may support the denial of administrative relief. If you believe it is appropriate, you may want to submit the case for technical advice.

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A copy of this memorandum should not be furnished to the taxpayer. This memorandum may not be cited as authority in any examination of a taxpayer's return.

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By:

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